

Summary Record

MEETING OF THE AUDIT REGULATORY COMMITTEE

31 January 2007

Pierre Delsaux, Director in DG Internal Market and Services chaired the meeting until 15:45 in the afternoon. Jürgen Tiedje, Head of Unit F4-Auditing, chaired the meeting as of 15:45 onwards.

The following points were discussed:

Agenda item I: Approval of the agenda of the meeting and approval of the minutes of the meeting of 11 October 2006

The agenda was adopted. One Member State suggested two changes to the minutes of the meeting of 11 October 2006. The changes were accepted.

Agenda item II: Co-operation between Member States and third countries

II.1. Commission informed the Member States on public consultation on third countries published on 11 January 2007. It gave an overview of issues covered by the consultation and invited also the Member States to comment.

II.2. Commission explained the status of preparation of third-country assessments and presented the interim report that summarises the country reports prepared so far (AuRC Working Document No. 2/2007). Horizontal issues and options how to approach them were presented and discussed. Member States were invited to comment on the methodology of the assessment and on individual horizontal issues.

General comments on methodology of third-country assessment:

- A Member State thanked the Commission for preparing this paper and stated that it will give comments on specific issues.
- One Member State pointed out that a more global approach to the assessment would be needed. Such approach should integrate criteria in all the three provisions concerned (Articles 45, 46 and 47). It also remarked that reciprocity is essential for the assessment as well as capacities of actors to efficiently co-operate
- A Member State disagreed with the preceding delegation in that there is a difference between assessment under Articles 45-46 and that under Article 47 since the former are based on equivalence whereas the latter is based on reciprocity.

Specific comments on horizontal issues raised in the interim report

On categorisation methodology and scope of assessment:

- A Member State remarked that the categories of third countries proposed in the report are not clearly determined. In particular a grey zone remains between category II and III. It suggested merging some of the categories.

- Another Member State asked whether the categories are relevant in the way they have been defined and what are the conditions for placing a country into a specific category. In general it supported the categorisation approach, but inquired about the criteria for choice of countries that have been assessed.
- One Member State opined that some categorisation of third countries is needed to proceed and that it may not be possible to draw clear lines between the categories since the situation is not black-and-white. The categorisation should not be a tick-box exercise – one should acknowledge differences of foreign cultures and traditions.
- A Member State expressed a view that the assessment should be based on the criteria of Article 46, but should focus on the body that is responsible for co-operation with the Member States. Ability to accord reciprocity should also be assessed.
- Another Member State agreed with the previous delegation. It remarked that the assessment should start with the main public oversight body and if this is not sufficient the assessment may be extended to other parts of the third-country system to fill the "gaps".
- Other Member State agreed with the two preceding delegations and added that one should take practical and pragmatic approach, but should deal with Article 47 issues separately.
- A Member State supported the position of the previous three delegations. It thought separating reciprocity assessment will be difficult. It also remarked that if the system is comprised of variety of bodies we should look at all of them.

The Chairman remarked that this issue will be re-visited on the next meeting. The conclusion is that the assessment should focus on the actual public oversight body and, if need be, cover also other parts of the third-country system.

On capacity for co-operation:

- A Member State expressed the view that ability of a third-country body to co-operate should be part of the assessment since otherwise the entire assessment would lose its sense.
- Another Member State stressed the need to distinguish between Article 46 and 47, adding that reciprocity is in any event a matter for Member States. It also expressed concern about the assessment of equivalence going beyond what is specified in Article 46.
- A Member State considered that equivalence has to be distinguished from reciprocity. It was of the view that there has to be a proven ability to co-operate. It also pointed out that it will be difficult to ascertain equivalence for data protection.
- One Member State opined that Article 47 provides a structure; thus a capacity for co-operation should be taken into account in the equivalence assessment under Article 46. Data protection should also be taken into account.
- A Member State remarked that the issue concerns third countries interested in regulating EU audit firms. Reciprocity should not be part of the equivalence assessment. Article 47 is relevant only where a third country regulates and supervises EU audit firms.
- Another delegation pointed out that one should assess the administrative capacity of third-country authorities to fulfil all that is needed for efficient co-operation. The willingness to establish relation with EU regulators should be part of the assessment. Where there is no communication there is no reason to recognise equivalence.

The Chairman concluded that the prevailing view is that third-country capacity to co-operate should be taken into account in the assessment, but it should be distinguished from reciprocity and Article 47 considerations.

Assessment of effectiveness of third-country public oversight:

- A Member State inquired about the meaning of the term "effectiveness". It explained that there is a difference between what is in the law and the performance of the institutions. It thus suggested concentrating on assessment of: (i) legal rules; (ii) whether these rules are in force; and (iii) whether they are applied.
- Another Member State suggested that the following should be taken into account in the assessment: (i) whether there is a regulatory/oversight system; (ii) whether it looks likely to deliver; (iii) whether it is applied in practice. It remarked that assessing effectiveness in terms of outcome is difficult.
- A Member State opined that the current assessment should not include effectiveness. This issue should be left for a future review of a Commission decision.
- A delegation expressed the view that effectiveness should be assessed at some point later.

The Chairman concluded that the Member States at this point prefer to postpone the effectiveness assessment to a later stage.

Reform plans of third countries and lack of official information

- A Member State was of the view that third-country reform plans should be taken into account once they have been published. As regards the jurisdictions with which we have no contact, it expressed reservation against the pragmatic solution based on location of audit working papers because this solution will not reduce the risk of poor quality of audit in these jurisdictions. It also expressed reservations against letters to non-responding jurisdictions. It requested that the Commission gives an overview of the legal framework for possible measures.
- Another Member State considered that the lack of answer from certain jurisdictions speaks for itself. This also indicates that there is no oversight or no oversight that would operate properly. It expressed a reservation against a proposed letter to jurisdictions that so far failed to respond.
- A Member State agreed with the preceding delegation. It had reservation against the idea of a 'last' letter to non-responding jurisdictions. It thought that these jurisdictions should be set aside and possibly re-assessed at a later stage.

The Chairman invited the Member States to comment in writing on the interim report within two weeks of the committee meeting. On the next meeting the above issues will be re-visited, as well as the preliminary categorisation of third countries.

Agenda item III: Co-operation with the USA

Commission informed the Member States about the discussions with the US PCAOB that took place in mid-January 2007. The Chairman then invited the delegations to provide information on whether national law in their respective jurisdictions bars the authorities from publicly disclosing the individual audit reports. The Chairman explained that the question is technical and the answers are needed for the assessment of possibilities for implementation of Article 47 of the Directive.

- A Member State expressed reservation to the topic. It considered the question too complex to be able to answer it on spot and inquired about the reasons for requesting this information. It expressed lack of willingness to provide an answer and pointed out that this is a political question.
- Another Member State explained that individual inspection reports may not be published in its jurisdiction, but they are summarised in the annual report. It also inquired about the reason for requesting the information.
- A Member State requested the Commission to put the question to the Member States in writing. The delegation then explained that the individual inspection reports are not publicly available in its jurisdiction. This however does not mean that nobody can gain access to them. There is a special body in this jurisdiction that assesses whether a document may be released. A regular report summarising the outcome of inspections and sanctions is publicly available.

The Chairman thanked the delegations and asked the Member States to provide information on rules on publication of individual inspection reports in writing within two weeks from the committee meeting.

Agenda item IV: Quality Assurance

Commission gave an overview of the developments in quality assurance systems in the world, including the EU. It suggested examining whether an "inspections system" should be the preferred method of quality assurance for audit firms auditing listed companies compared to the "monitored peer review" system. This might require reviewing the Commission Recommendation of 2000 on quality assurance for statutory audit in the EU. The 2000 Commission Recommendation considered inspections and monitored peer review to be on equal footing in terms of their independence. Following the presentation, the Member States were invited to express their views:

- A Member State questioned whether for smaller countries "inspection" system was at all possible for various, though primarily budgetary reasons as well as due to difficulties in finding suitable inspectors. It also emphasized that in communication between the "monitored peer review system" and "inspection system" the organisation monitoring the peer review would have to play a pivotal role.
- Another Member State informed that according to the 2005 legislation the activities of peer reviewers were monitored by associations without the involvement of the profession. During the reviews the profession was however involved, though subject to strict rules.
- A delegation commented that it was difficult to run a system other than a monitored peer review since it is difficult to find a sufficient number of qualified inspectors.

The Chairman explained that both "monitored peer review" and "inspection" systems are accepted under the 8th Directive, but this did not ensure harmonisation in the EU. This might cause problems with third countries as well as for co-operation within the EU. The Chairman considered that the Commission should at some point take a position on this issue to take account of the developments in the world as well as in the EU. The Chairman remarked that concerned were primarily listed companies and that in any event it would be difficult to have "one size fits all" approach in the EU. It was concluded that it was premature to give details on the content of the Commission Recommendation.

Agenda item V: International Standards of Auditing

IAASB presentation

The agenda point was opened by a presentation given by Mr. John Kellas (JK), Chairman of IAASB and Ms. Denise Esdon (DE) Deputy Chair, IAASB. The presentation concerned IAASB internal working procedures, project Clarity as well as IAASB future strategy and work plans. They stressed that the IAASB strives to develop proportionate standards yet suitable for regulators. To maintain high quality standards, JK supports implementing timely feedback on issues encountered with ISAs from audit regulators arising from their activities.

Following the presentation, the floor was open for questions.

- A Member State enquired how due process was followed.
- JK reminded the main features of the due process. He took the view that the design of the on-track procedure is up to the AuRC, but that the presence of a Commission observer to IAASB meetings is a great asset since accelerating the Clarity project up until 2008 instead of 2011 results in time pressure. He reminded that “pre-pre” versions of the standards were generally published months ahead the final approval, a period of time that could be used by the Member States to get familiar with the issues before addressing the final version four weeks before approval. He stressed that delaying final approval from one meeting to the next may look like an attractive solution, but carried the following disadvantages: (i) all constituencies, not just the EU, would have then to be given an opportunity to add last minute comments, and (ii) comments raised during that period would probably have already been addressed during due process. Finally, (iii) the PIOB approved the current due process.
- Commission services reminded the benefits of an on-track procedure, i.e. mainly to avoid last minute surprises for the Member States. The Commission may try to work out and improve such procedure if the Member States decide whether they support the principle of an on-track procedure.
- A Member State supported the on-track proposal, but with a longer period than 4 weeks given to the Member States to react.
- An observer enquired on the status of the drafting of objectives by IAASB.
- A Member State enquired whether requirements could be dissociated from application material.
- For a Member State, guidance is not vital and may prove difficult to adopt as legislation. In addition, it wondered to what extent can ISA 700 be considered as stand alone, and sufficiently jurisdiction neutral with respect to management’s overall responsibilities and specific to internal controls.
- An observer does not have much sympathy with the idea of guidance becoming legislation, but reminded that it works, as shown by the experience with IASs. In addition, we should not lose sight that ISAs are international standards undergoing enhancements because of international considerations preferably to local considerations.
- JK reminded that the revised Preface has just been approved. The approach on objectives will be taken from the Preface into the Exposure Draft of ISA 200 of April 2007. This approach strives to be as realistic and predictable as possible, but not to downgrade the quality of ISAs. The IAASB believes that Application Material is useful because not all practitioners are so experienced as to understand the requirements without guidance. US PCAOB standards, and Japanese GAAS include

guidance. ISA 200 requires auditors to read the application material. ISA 700 is designed to address EU concerns. It refers to auditors' responsibility in addressing internal controls but does not copy the US model. ISA580 is out for exposure. IASs strive not to set new management responsibilities but to clarify the respective responsibilities of auditors versus management.

- A Member State reminded that the EC is the “main client” of the IAASB and enquired how the IAASB intended to organise dialogue with the EU and whether the IAASB due process is in line with recommendations of the Financial Stability Forum. It was also concerned that there are so many members at the IAASB coming from jurisdictions that do not apply ISAs.
- JK agreed that the EU is a very prominent client but that the IAASB must ensure that appropriate weight is given to all commentators. As such, regulators' and governmental comments carry more weight than the profession's. There are chances that ISAs are adopted in the US for non public companies in the future.
- The Commission concluded that such dialogue between the IAASB and the AuRC should be prolonged in the future.
- The IAASB representatives agreed, thanked and left the room.

Possible Consultation paper on ISA

The Commission services presented AuRC Working Document No. 3 that might serve as a basis for a possible public consultation by late spring 2007.

- Four Member States support the merger of the options presented in Question 2, as they do not exclude each other, i.e. international recognition of ISAs through their use by professionals, and through recognition by international regulators such as IOSCO. One Member State also advocated a more integrated presentation of the options. For another Member State Option 1 may prove difficult to implement since no jurisdiction will have adopted the fully fledged set of clarified standards by the time the EC will consider the adoption of the ISAs.
- Two Member States suggested a clarification of the meaning of Question 4 regarding how companies should be consulted on ISAs.
- On Q4, a Member State thought it should raise the issue of whether the adoption of ISAs might change the restrictive responsibilities of management and auditors.
- One Member State is concerned with the prominence given to the on-track procedure in the document, especially as long as the IAASB shows reluctance to give prominence to EU concerns. There is merit to have the PIOB, but the latter is not very convincing unless more prominence is given in it to EU representatives. Therefore the answer of the Member State to Question 1 on whether the governance of IFAC is appropriate is “no”. It supports upfront input from the Member States and the EC into ISAs, but:
 - is the 4 weeks period for comments enough to be efficient?
 - up front debates on major issues re substance should be organised at AuRC level, including what to do with the application material and fundamental concepts of ISA 200.

As an aside, the Member State does not support raising in a public consultation questions that are by nature political, not technical, on which the AuRC should not appear committed.

- A delegation sees no credible alternative to the on-track procedure, but supports the Member States making their opinion earlier than the 4 weeks period currently proposed.

- Two Member States believe that the right process for adopting standards is central. 4 weeks is not enough. The IAASB could not be expected to give undue prominence to the EU's views because this would cut across due process. But the AuRC needed to be able to react between the IAASB meetings when an ISA is being finalised.
- A Member State agrees with the previous delegation and supports obtaining results well ahead of the 4 weeks period. On section 3 of the document, it is crystal clear that the Application Material should not be adopted through a binding instrument, but that a proper vehicle for endorsement should be found.
- A Member State is concerned that requirements cannot be understood without the corresponding application material, as mentioned by JK and underlined that Application Material should not represent a body of parallel rules.
- A Member State agrees with the previous delegation that an instrument different from the one used to adopt requirements should be found to introduce the application material.
- A Member State supports the two previous delegations' views, with a preference for a Commission Recommendation to endorse the application material. Such solution would ensure the following benefits:
 - since requirements are not self-sufficient, the application material would be endorsed.
 - It fits in with the better regulation program;
 - It would help ensuring consistency of enforcement of ISAs in the EU
- Another delegation encourages the Commission to explore ways for endorsing the application material, a Recommendation being one of these. We should avoid having requirements in these.
- An observer supports the endorsement of the application material.
- The Commission services concluded as follows:
 - IAASB governance will be debated at the next AuRC meeting
 - Option 1 and 2 will be merged in the document
 - Question 4 on the role of companies will be clarified
 - The Commission will explore alternative mechanisms to endorse application material.
 - The message will be passed on to the IAASB to develop self-sufficient requirements and clear objectives.

VI Simplification Agenda: alleviating administrative burden of SMEs

The Chairman presented the working documents prepared for this meeting summarising responses received from the Members of the AuRC on a questionnaire about alleviating the administrative burden of SMEs regarding auditing. A consultation of the ARC is also ongoing.

- A Member State generally opposes the proposals made by the Commission in the paper. It underlines that the approach of the Commission risks presenting any rule in law as an administrative burden. Audits of SMEs are necessary for financial stability. The Member State does not support introducing any other type of assurance than audits (such as limited reviews) because simplified engagements might confuse the public perception of the role and value added by a statutory auditor. Each time a statutory auditor performs an assurance engagement, the engagement should be an audit. The proposal to explore exemptions for group subsidiaries is not promising

because the statutory part of the audits at subsidiary level would no longer be performed with such exemption, whereas this brings value to the public.

- Four Member States do not support introducing different assurance engagements than audits, even on a voluntary basis. For one Member State, a principles based approach in ISAs should solve many problems. Another Member State supports the way SMEs audits are addressed in the application material in the ISAs and believes that exemptions for group subsidiaries would simply shift the burden towards group auditors.
- In a Member State there is no audit obligation for smaller entities. However the audit is not seen as an administrative burden by nature.
- Another delegation had no views as yet regarding the issue, but is open minded. It may prove useful to address whether audit is an unnecessary administrative burden or offers benefits e.g. regarding credit rates for bank loans. Limited Reviews are no promising way forward. The trade-off is between e.g. credit rate for bank loans and audit cost.
- In a Member State audits represent an administrative burden but also, one should consider its benefits. It supports addressing the question of the burden of audits from a cost-benefit perspective.

VII Work Program for AuRC for 2007

The Commission distributed a preliminary work program for the AuRC for 2007 and invited the Member States to give their comments (also following the meeting in writing).

Comments:

- A Member State pointed out that a debate over substance of ISAs is needed. It inquired on when the results of public consultations will be available and emphasised that the IFAC Code of Ethics is a very important subject that needs to be discussed further. As regards auditors' responsibility, the Member State objected to possible recommendation that has been put on a preliminary program of the AuRC for 2007. It insisted that the idea of recommendation departs from the 8th Directive and that the Commissioner for Internal Market and Services is not respecting the boundaries set by the Directive.

The Chairman replied to the question on timing of public consultations: the deadline for consultation on third countries is 5 March 2007 and auditors' liability 15 March 2007. The Chairman concluded that the work program for the AuRC for 2007 may be discussed further in the next meeting and that the Member States are welcome to submit their comments also in writing.

VIII AOB

Next meeting of the AuRC is planned for 8 March 2007.

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Austria

Ministry of Justice

Belgium

Ministry of Economics

Bulgaria

Cyprus

Permanent Representation

Czech Republic

Ministry of Finance

Denmark

Danish Commerce and Companies Agency

Ministry of Economic and Business Affairs

Estonia

Ministry of Finance

Finland

Ministry of Trade and Industry

France

Ministère de la Justice

Ministère de l'Economie, des Finances et de l'Industrie

Germany

Federal Ministry of Economics and Technology

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Portugal

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Ministry of Public Finance

Chamber of Financial Auditors

Slovakia

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Accounting and Auditing Institute (Instituto de Contabilidad y Auditoría de Cuentas) (ICAC)

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